

TEACHERS' RETIREMENT BOARD
INVESTMENT COMMITTEE

SUBJECT: Real Estate - RFP for Real Estate Managers

ITEM NUMBER: 4

ATTACHMENT(S): 3

ACTION: X

DATE OF MEETING: September 2, 1998

INFORMATION: _____

PRESENTER(S): Mr. Pleis

EXECUTIVE SUMMARY

One of the 1998-99 objectives for real estate was "To complete a request for proposal (RFP) for real estate mandates, as approved by the Investment Committee, to implement the overall real estate strategy".

This RFP incorporates the role of real estate and the composite risk profile approved in the April 1998 Investment Committee meeting. The services to be provided have been designed to facilitate implementation of the low to moderate risk strategy. The services to be provided incorporate the Investment Committee discussions regarding manager discretion. The proposed fee schedule is based on the August Investment Committee discussion on incentive fees for real estate managers.

Detailed information regarding the RFP provided in Attachment 1 include:

1. Timeline for the RFP
2. Purpose of the RFP
3. Services to be Provided
4. Minimum Qualifications
5. Fee Structure
6. Proposal Evaluation Criteria

Implementation of the terms and conditions included in this RFP requires a modification to the Real Estate Policy allowing delegation of acquisition and disposition discretion to an external real estate manager.

Staff is proposing that the contract participation goal requirement for Disabled Veterans Business Enterprise be required after the final selection process is completed. Upon submission of proposals to STRS, all proposers shall execute a certification, included as Attachment 2,

confirming their intent to submit the necessary documentation to STRS in the event they are selected. Each manager shall be required to submit documentation substantiating compliance with the goal prior to the final execution of their contract.

RECOMMENDATON

Paralleling the process for the Domestic Equity Managers and the Non-U.S. Equity managers search and in concert with the Cortex recommendations, Attachment 3 is a resolution reflecting staff's recommendation that the Investment Committee approve the following:

1. Modify the real estate policies to allow external real estate managers acquisition and disposition discretion up to \$100 million per transaction.
2. Release of the Request for Proposal as described in Attachment 1.
3. Use of a "Manager Pool" of qualified active managers to replace terminated managers or to supplement the roster of contracted managers.
4. Use of opened ended contracts (Evergreen contracts).
5. Delegation of the "Final Selection" to staff.

STATE TEACHERS' RETIREMENT SYSTEM
REAL ESTATE MANAGER(S)

TIME SCHEDULE:

Date of Issue:	<u>October 1998</u>
Deadline for Submission of Written Questions:	<u>October 1998</u>
Final Filing Date:	<u>December 1998 @ 4:30 p.m.</u>
Pre-evaluation Screening:	<u>December 1998</u>
Proposal Evaluation:	<u>December 1998 - February 1999</u>
Interviews:	<u>February 1999</u>
Submission of Contract Partici- pation Goal Documentation:	<u>To be Announced</u>
Reference Checks:	<u>To be Announced</u>
On-Site (Optional):	<u>To be Announced</u>
Post Notice of Intent to Award:	<u>Immediately After Selection</u>
Award of Contract:	<u>5 business days after posting notice of intent to award</u>

STATE TEACHERS' RETIREMENT SYSTEM
REQUEST FOR PROPOSAL
REAL ESTATE MANAGER(S)

I. INTRODUCTION

The California State Teachers' Retirement System (STRS) administers an investment portfolio with approximately \$88.3 billion in total assets. As of June 30, 1998, the assets were invested as follows: \$36.0 billion in domestic equities; \$18.5 billion in non-U.S. equities; \$2.6 billion in global TAA; \$26.0 billion in domestic fixed income securities; \$2.1 billion in real estate equity; \$2.0 in alternative investments; and \$1.1 billion in cash reserves. The Investment Management Plan adopted by the Teacher's Retirement Board (Board) provides an investment structure designed to provide diversification within each component of the portfolio. The real estate portfolio contains direct and commingled fund components. The direct component of STRS real estate portfolio includes industrial, office, retail and apartment properties. STRS is in the process of soliciting proposals from firms that have expertise in acquisition, management and disposition of directly owned real estate.

STRS intends to award contracts to a maximum of twelve (12) Real Estate Investment Management Firms. STRS reserves the right to determine the number of contracts which will be awarded, as well as the amount of each allocation. In the event that none of the proposals are satisfactory, then no selection will be made. Upon award of a contract(s), STRS shall develop investment objectives for each specific manager.

II. PURPOSE

Pursuant to Education Code 22353, STRS is seeking qualified firms to provide investment management services for direct real estate investments. STRS defines direct real estate as office, industrial, retail and apartment properties owned 50% to 100% by STRS with the performance of the property bench marked against the NCREIF property index. The firms selected will be fiduciaries of STRS and have specified discretionary authority with respect to STRS' assets. Firms may bid on separate services (i.e. acquisitions or asset management) or on all the services. (i.e. acquisition, asset management and disposition). Also, a firm can bid on any or all of STRS existing assets within the real estate portfolio as it relates to asset management only.

STRS will also establish a "pool" of qualified managers from this process. This pool would be used to replace managers that might be terminated in the future or to add a manager(s) as necessary. Contracts will be executed prior to funding.

III. SERVICES TO BE PROVIDED

- A. Contractor will acquire, manage and dispose of directly owned real estate assets in accordance with STRS' investment policies, procedures and discretion framework. Except as otherwise provided in the manager's contract, the manager will have specified discretion as outlined in Exhibit A. Contractor will provide a dedicated management team on STRS portfolio if \$400 million or more is under management.
- B. Contractor will provide STRS with annual business plans, hold/sell analysis and property operating budgets.
- C. Contractor will arrange for the property management and leasing services for each property. In the event the contractor's company provides property management and leasing services the contractor will be held responsible under said contract for the performance of affiliated service providers. Also, all fees paid to an affiliate service provider must be market based. The asset management fee provided for in the contract shall be exclusive of the compensation for property management and leasing services.
- D. Contractor will provide periodic reporting to STRS or designated agent on the numerical performance, physical characteristics and marketplace positioning of individual property investments.
- E. Contractor will adhere to the Board's Statement of Investment Guidelines, Objectives and Performance Criteria, which will be developed by STRS specifically for each manager chosen and will be incorporated by reference into the contract(s).
- F. Contractor will provide regular advice to STRS on market conditions, including positive and/or negative trends.
- G. Contractor will provide reports to STRS and consultants as required by STRS.
- H. Contractor will attend Investment Committee, Board and/or staff meetings as requested by STRS.

IV. MINIMUM QUALIFICATIONS

The proposer must meet all of the following minimum qualifications to be given further consideration. Failure to satisfy each of the minimum qualifications will result in immediate rejection of the proposal.

- A. As of June 30, 1998, the firm must have been in business at least one year.
- B. As of June 30, 1998, the firm must have a minimum of \$250 million in real estate assets under management.
- C. The portfolio manager(s) assigned to the STRS account must each have a minimum of 5 years of real estate portfolio management experience.
- D. The primary professional assigned to the STRS account must have a minimum of three years experience managing real estate assets on behalf of institutional investors.

STATE TEACHERS' RETIREMENT SYSTEM
REAL ESTATE MANAGER(S)

FEE SCHEDULE

Name of Proposer

I. CONTENT AND METHOD OF PAYMENT

Proposers must submit their fee schedule for direct real estate management services as outlined in the format prescribed below. The proposed fee schedule shall include all costs for providing investment services to STRS as described in this RFP. The asset management fee earned by the manager will be paid quarterly in arrears by STRS for all appropriately invoiced charges consistent with the fee schedule below.

While there is no maximum fee established, the Proposer is reminded that fees represent 30% of the evaluation process. The fee proposals will be evaluated on the asset management fee proposals effecting STRS existing properties and the proposers complete fee package for new equity invested. A sample portfolio of \$500 million in new properties that were invested and sold by the same advisor over a five year period will be used in evaluating the proposers fees.

Once the Contractor is selected, the fee may be further refined depending on factors which may affect the proposed fee. In no case will the refined fee be higher than the fee contained in this proposal.

II. PROPOSERS' CONSIDERATIONS

In completing the fee schedule, proposers should take into account the following:

1. STRS staff and Investment Committee will control the overall portfolio decisions (i.e. allocation and diversification).
2. The Contractor will be given specific investment discretion at the asset level and be held accountable for the investment performance.
3. STRS emphasis under this contract will be on maximizing cash flow.
4. Little or no leverage will be applied to new or existing assets.
5. STRS emphasis under this contract will be long term wealth creation versus capturing short term gains.
6. Compensation will reflect the investment time horizons of the overall Fund.
7. STRS target real estate allocation is 5%. The current allocation, at market value, of the real estate portfolio is 2.1%. Over the next several years, STRS plans to allocate additional equity to real estate.
8. STRS existing assets will be awarded to one or more successful proposers as part of the RFP selection process. Exhibit B identifies STRS existing directly

owned properties. Any of STRS existing assets transferred to a successful bidder will be subject, only to asset management fees identified in Section II - Asset Management Fee.

9. Exhibit C gives definitions of key words used in determining fees.

SECTION I - PERFORMANCE BASED ACQUISITION FEE

Proposer's consideration for acquisitions fees, if any, should include the following:

1. Calculation of acquisition fees will be based on the three year performance of individual properties. At the end of year one, two and three an acquisition fee will be calculated on the contractors' ability to meet or exceed two benchmarks. Benchmark #1 - Contractor must meet or exceed their own net operating income projections in their initial acquisition proforma. Benchmark #2 - Contractor must equal or exceed the NCREIF Property sub-index for the specific transaction. The performance acquisition fee shall be calculated on the lower of the two benchmarks for each time period indicated below.

Acquisition Fee Payment Intervals	Proposer Annual Fee as a % of STRS Purchase Price
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12 month fee calculation

- Annual Net Operating Income 105% or more
of Acquisition Proforma or total return
of property(s) 110% or more of the NCREIF _____
Property sub -index.
- Annual Net Operating Income between 100%
and 105% of Acquisition Proforma or total
return of property(s) between 100% and 110% _____
of NCREIF Property sub-index.
- Annual Net Operating Income less than 100%
of Acquisition Proforma or total return of
property(s) less than 100% of the NCREIF No Fee Paid
Property sub-index.

24 month fee calculation

- Annual Net Operating Income 105% or more

of Acquisition Proforma or total return

of property(s) 110% or more of the NCREIF

Property sub-index.

- Annual Net Operating Income between 100%,
and 105% of Acquisition Proforma or total
return of property(s) 100% and 110%

of NCREIF Property sub-index.

- Annual Net Operating Income less than 100%
of Acquisition Proforma or total return of
property(s) less than 100% of the NCREIF

Property sub-index.

No Fee Paid

36 month fee calculation

- Annual Net Operating Income 105% or more
of Acquisition Proforma or total return
of property(s) 110% or more of the NCREIF

Property sub-index.

- Annual Net Operating Income between 100%,
and 105% of Acquisition Proforma or total
return of property(s) 100% and 110%

of NCREIF Property sub-index.

- Annual Net Operating Income less than 100%
of Acquisition Proforma or total return of
property(s) less than 100% of the NCREIF

Property sub-index.

No Fee Paid

SECTION II - ASSET MANAGEMENT FEES

Proposer's consideration for asset management fees should include the following:

1. STRS will calculate the asset management fee as a percentage of net operating income collected on the contractors portfolio under management.
2. All disposition services for the sale of a property or portfolio shall be included within the asset management fee structure.
3. Dedicated portfolio and asset management teams will be required by STRS for any contractor that manages \$400 million or more in assets.

<u>STRS Net Operating Income</u>	<u>Annual Percentage of STRS Net Operating Income</u>
Up to \$5 Million	_____
Next \$10 Million	_____
Next \$10 Million	_____
Next \$10 Million	_____
Next \$10 Million	_____
Over \$45 Million	_____

SECTION III - INCENTIVE FEE

Proposer's consideration for the incentive fee, if any, should include the following:

1. The incentive fee will be based on the ultimate performance of individual properties and the total portfolio upon sale or upon independent valuation after completion of a ten year holding period.
2. A dual benchmark approach will be used to determine if the advisor is entitled to receive an incentive fee. The fee will be calculated as a percentage of profits paid after achievement of a cumulative, compounded 10% net hurdle rate of return at both the investment level as well as the portfolio level. The portfolio must also exceed a customized benchmark based on the property types the advisor will manage. Please provide a percentage bid below for the incentive fee calculation.

_____ % over a 10% net hurdle rate of return.

Proposer's Authorized Signature

Date

REAL ESTATE MANAGER(S)
WRITTEN PROPOSAL EVALUATION SHEET

Name of Proposer

		MAXIMUM POINT <u>SCORE</u>	PROPOSER'S POINT <u>SCORE</u>
A.	PROPOSAL QUESTIONNAIRE		
	<u>Section I</u>		
	Organizational Background		
	Professional Staff		
	Properties Under Management		
	Subtotal	<u>30</u>	
	<u>Section II</u>		
	Investment Philosophy		
	Decision-Making Process		
	Portfolio Management Process		
	Research		
	Client Servicing		
	Subtotal	<u>65</u>	
	Total Sections I & II*	<u>95</u>	
	<u>Section III</u>		
	Performance	<u>40</u>	
	Total Item A	<u>135</u>	
B.	FEES	<u>90</u>	
C.	INTERVIEW**	<u>135</u>	
D.	ON-SITE	<u>pass/fail</u>	
	GRAND TOTAL	<u>360</u>	

* A proposer must receive a combined score of at least 66 points on Sections I and II to be given further consideration.

** A proposer must receive a minimum score of 95 points on the Interview to be given further consideration.

Rater No. _____

Date _____

Exhibit A

**California State Teachers' Retirement System
Discretion Guidelines for Real Estate Managers**

STRS intends to delegate investment discretion to its real estate managers, subject to certain investment parameters determined with reference to STRS portfolio guidelines. The intent is for managers to have specified discretion to acquire, manage and sell properties with their portfolio. Each firm will be given an allocation with an investment charter to manage and/or acquire properties within proscribed territories and/or within certain property sectors, defined with reference to the NCREIF index. Certain investment criteria must also be met prior to investment of new properties. Reinvestment of capital within the original mandate is contemplated.

It will be the role of STRS Staff to serve in the capacity of STRS portfolio manager. As such, Staff will continually monitor proposed acquisition and disposition activities to ensure the composite portfolio is structured to achieve its goals. Compliance with Board approved investment policies with respect to the diversification of the composite portfolio is an essential component of portfolio management. Managers will be required to notify Staff of proposed acquisition/disposition plans so that Staff can determine the impact on the composite portfolio.

Constraints on the manager's investment decisions would be imposed by Staff to the extent the manager's proposed actions would cause STRS to deviate from the policy guidelines approved by STRS' Board. For example, assume a manager has the mandate to manage STRS existing office properties and acquire new office properties within the Western NCREIF Index region. STRS portfolio at the time has an office exposure within the region within policy guidelines. The manager proposes to sell a large office property, which would have the result of causing STRS to fall below its allocated range for the office sector in that region. In that instance, Staff could prevent the sale, unless the manager had a plan for the reinvestment of capital that would bring the portfolio back into compliance with the pre-approved guidelines.

Managers will be held accountable for their investment performance, as they will have investment discretion. The only exceptions will pertain to those assets in which an investment decision was changed by Staff due to portfolio level constraints. Staff will assume accountability for the performance of those assets after the date of the recommendation. Agreed-upon custom benchmarks (e.g., the performance of office properties in the Western NCREIF region, using the example above) will be used to determine whether the manager's performance fails within an accepted range. Managers will be given a reasonable time period to demonstrate their performance, which is initially contemplated to be three years. Poorer performing managers will be recommended for termination.

Example of discretion parameters for western region office properties:

Region & Metro Size	Property Type	Ownrship Structure	Debt	Initial Cash Yield	Portfolio Size	Risk	Bench Mark
West Metro >2mm	Office	100% Equity	None	8.0%	\$800mm	Low	NCREIF (Office Sector West Sub- Index)

Example of roles and responsibilities:

Manager	STRS Staff	STRS Consultant
Purchase properties within criteria	Ensure acquisition disposition and capital improvements are within policy guidelines	Oversee policy compliance
Submit annual operating budget		Monitor staff and manager implementation
Manage properties within criteria	Review annual operating budgets	Monitor manager performance
Sell properties within criteria	Monitor manager performance	

Exhibit B
California State Teachers' Retirement System
Directly Owned Real Estate Portfolio

<u>Product Type</u>	<u>Location</u>	<u>State</u>	<u>Square Ft</u>	<u>Valuation</u> <u>Jun-98</u> <u>(\$000)</u>
OFFICE				
University Office	Sacramento	CA	184,719	\$23,000
Westwood Plaza	Los Angeles	CA	136,824	35,000
Riverbend	Hartford	CT	155,149	11,100
1325 G St.	Washington	DC	285,797	48,100
1990 M St.	Washington	DC	104,967	16,100
1120 19th St	Washington	DC	109,126	17,600
Wilshire Landmark	Los Angeles	CA	284,395	88,800
Pacific Financial Plz	Newport Beach	CA	271,661	79,500
Davies Pacific	Honolulu	HI	362,346	63,000
Pan Am Bldg	Honolulu	HI	220,863	35,000
9595 Wilshire	Beverly Hills	CA	161,143	44,300
9720 Wilshire	Beverly Hills	CA	56,408	12,200
Northrop Plaza	Los Angeles	CA	544,248	123,200
Coastal Tower	Ft. Lauderdale	FL	261,700	34,900
RETAIL				
Anaheim Plaza	Anaheim	CA	246,200	45,300
The Oaks	Thousand Oaks	CA	359,000	130,000
The Parks	Arlington	TX	359,096	98,500
The Quarry	Hodgkins	IL	411,145	25,500
High Ridge	Racine	WI	260,784	16,900
Centerpointe	Woodridge	IL	441,690	33,100
INDUSTRIAL				
Pacific Northwest	Seattle	WA	3,718,097	133,600
Pacific Commerce	Compton	CA	334,000	15,000
Miramar Industrial	San Diego	CA	272,802	15,100
Alondra Midway	Cerritos	CA	266,385	12,700
Santa Fe Corp	Santa Fe Springs	CA	337,795	17,100
Rancho Pacifica	Rancho Dominguez	CA	1,161,856	56,700
Southrail	Chula Vista	CA	224,026	11,100
Crocker Park	Brisbane	CA	940,570	55,000
APARTMENTS				
			<u># Units</u>	
Waterford	St. Petersburg	FL	384	19,700
Stratford Place	Bloomington	IL	342	28,000
Briar Meadows	Houston	TX	256	13,800
Vista Del Lago	Dallas	TX	296	21,800
San Paloma	Scottsdale	AZ	324	29,200
Mesa Verde	Austin	TX	358	22,800
Kensington Sq.	Dallas	TX	236	16,200
Calavera Pointe	Westminister	CO	276	20,100
Pinnacle Highline	Littleton	CO	228	18,800
Camden	Bloomington	IL	360	27,400
Isle at Sawgrass	Sunrise	FL	368	23,900

Exhibit C
California State Teachers' Retirement System
Definitions

Net Operating Income (NOI) - Is defined as all revenues derived from a property less property operating expenses. Excluded from the NOI calculation are capital improvements, advisory fees paid by the fund, financial audits, appraisals, bank charges, tenant improvements, leasing commissions, debt service and any portfolio allocated cost.

Acquisition Proforma - Shall be defined as the ten year property cash flow projection, including capital improvements, leasing commissions, tenant improvements and reserves, at the time the acquisition was approved by the managers investment committee. Over the measurement period, which shall be three years from the anniversary date of the property acquisition, the projected performance of the property will reflect net operating income (as defined above), capital expenditures, and net cash flow generated. The acquisition proforma will not include projections of potential capital appreciation during the three year period. The acquisition proforma will be agreed upon between the manager and STRS real estate staff at the time of managers investment committee approval.

Net Hurdle Rate - Shall mean the net return the manager must generate prior to receiving an incentive distribution. The manager's performance will be calculated as an annual internal rate of return to be earned by STRS from its investment during the calculation period. The internal rate of return shall exceed 10% during the calculation period and shall be computed after deducting all fees and expenses incurred, which shall also include the impact of the potential incentive distribution, as of the date of the calculation.

CERTIFICATION TO COMPLY WITH
DISABLED VETERAN BUSINESS ENTERPRISE
CONTRACT PARTICIPATION REQUIREMENT

I/We have agree to comply with the Contract Participation Goal requirements. It is understood and agreed that, should our firm be selected as a successful Proposer for this process, the required documentation shall be completed and submitted to STRS to substantiate compliance with the requirements. Documentation shall be submitted prior to the posting of the Notice of Intent to Award, on a date specified by STRS, and shall be subject to STRS' review and approval. We further understand that if this documentation is insufficient and cannot be corrected prior to the date specified by STRS, an agreement cannot be executed..

Proposer's Authorized Signature

Title

Company Name of Proposer

Date

PROPOSED
RESOLUTION
OF THE
TEACHERS' RETIREMENT BOARD
INVESTMENT COMMITTEE

SUBJECT: Request for Proposal for
Real Estate Manager(s)

Resolution No. _____

WHEREAS, the Board is responsible for managing the Teachers' Retirement Fund (Fund), a Pension Fund; and

WHEREAS, the Board desires to contract with external real estate managers with expertise in variety of investment styles to implement the overall real estate strategy; and

WHEREAS, the Committee has reviewed the written material and oral presentation from staff and Pension Consulting Alliance; Therefore be it

RESOLVED, that the Committee hereby approves the following:

1. Modify the real estate policies to allow external real estate managers acquisition and disposition discretion up to \$100 million per transaction.
2. Release of the Request for Proposal as described in Attachment 1;
3. Use of a "Manager Pool" of qualified active managers to replace terminated managers or to supplement the roster of contracted managers;
4. Use of opened ended contracts (Evergreen contracts), and ;
5. Delegation of the "Final Selection" to staff.

Adopted by:

Investment Committee
on _____

James D. Mosman
Chief Executive Officer